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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC) REVIEW OF BELGIUM AND LUXEMBOURG (BLEU)

REF: EDR(77)12

1. SUMMARY: IN REFDOC CIRCULATED FOR MAY 13 EDRC REVIEW OF BLEU, SECRETARIAT NOTES THAT IN 1976 AND IN 1977, BELGIUM MADE SIGNIFICANT PROGRESS IN REDUCING INFLATION RATE. HOWEVER, RECOVERY WAS MODERATE, UNEMPLOYMENT SITUATION WORSENER, ALREADY LARGE PUBLIC SECTOR DEFICIT WIDENED AND BLEU CURRENT ACCOUNT DEFICIT DETERIORATED APPRECIABLY. MOREOVER, ON MORE THAN ONE OCCASION, BELGIAN FRANC WAS SUBJECT TO SPECULATIVE ATTACK. VARIATIONS IN ECONOMIC ACTIVITY IN BELGIUM LED TO SHIFTS IN FISCAL POLICY WITH RESTRICTIVE "SOBRIETY PLAN" IMPLEMENTED IN EARLY 1976 GIVING WAY AT START OF 1977 TO EGMONT PLAN WHICH AIMS TO STIMULATE INVESTMENT AND TO

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COMBAT UNEMPLOYMENT. MONETARY POLICY WAS GIVEN OVER TO DEFENSE OF FRANC. SECRETARIAT FORECASTS LOWER GDP GROWTH (2.75 PERCENT) THAN DOES GOB AND FEELS THAT SOMEWHAT MORE STIMULATORY FISCAL POLICY THAN CURRENTLY INTENDED MIGHT BE IN ORDER FOR BOTH DOMESTIC AND INTERNATIONAL REASONS. IN ADDITION, SECRETARIAT REMARKS THAT "MORE DRASTIC" MEASURES TO REDUCE UNEMPLOYMENT SUCH AS SHORTER

WORKING HOURS MAY BE IN ORDER. FINALLY, SECRETARIAT STRESSED THAT EFFORT TO MODERATE GROWTH OF WAGES AND PRICES SHOULD BE CONTINUED AND HIGHER TAXES AND GREATER EXPENDITURE CONTROL WILL BE NECESSARY TO REDUCE BUDGET DEFICIT OVER MEDIUM TERM. LACKLUSTER PERFORMANCE OF LUXEMBOURG ECONOMY IN 1976 LARGELY ATTRIBUTABLE TO DEPRESSED CONDITIONS IN STEEL MARKET; SECRETARIAT DOES NOT EXPECT MARKED IMPROVEMENT THIS YEAR. ACTION REQUESTED: MISSION WOULD APPRECIATE COMMENTS/QUESTIONS WHICH COULD BE USEFULLY POSED AT REVIEW. (NOTE: REP FROM EMBASSY BRUSSELS WILL PARTICIPATE IN REVIEW.)

2. BELGIAN SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: SECRETARIAT NOTES THAT ECONOMIC RECOVERY, WHICH BEGAN AT END OF 1975, TAPERED OFF SUBSTANTIALLY DURING 1976 DUE TO WEAKNESS OF BOTH DOMESTIC AND FOREIGN DEMAND. DOMESTIC DEMAND GREW BY ONLY 1.4 PERCENT IN REAL TERMS, IN CONTRAST TO SECRETARIAT AND GOB FORECAST OF 2.8 PERCENT. PRIVATE CONSUMPTION GREW ONLY MODERATELY AND VOLUME OF NON-RESIDENTIAL FIXED INVESTMENT DECLINED FOR SECOND YEAR IN SUCCESSION. SUPPLY SIDE OF ECONOMY SHOWED SIMILAR WEAKENING PATTERN; INDUSTRIAL PRODUCTION ROSE 10 PERCENT ON AVERAGE FOR 1976, BUT WAS INCREASING AT ANNUAL RATE OF ONLY 1.5 PERCENT AT YEAR-END. UNEMPLOYMENT RATE STOOD AT 6.4 PERCENT IN MARCH, 1977 COMPARED WITH 5.5 PERCENT A YEAR EARLIER.

3. SLOWER GROWTH OF WAGES IN 1976 TRACEABLE, IN SECRETARIAT'S VIEW, TO EFFECTS OF INDEXATION ON WAGES IN CIRCUMSTANCES WHERE INFLATION RATE DECELERATING, AND TO MORE MODERATE NEGOTIATED SETTLEMENTS. WAGE DEVELOPMENTS TOGETHER WITH EFFECTS OF FALL IN IMPORTED RAW MATERIALS PRICES IN 1975 CONTRIBUTED TO IMPROVED INFLATION PERFORMANCE.

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CUMSTANCES WHERE INFLATION RATE DECELERATING, AND TO MORE MODERATE NEGOTIATED SETTLEMENTS. WAGE DEVELOPMENTS TOGETHER WITH EFFECTS OF FALL IN IMPORTED RAW MATERIALS PRICES IN 1975 CONTRIBUTED TO IMPROVED INFLATION PERFORMANCE.

4. OUTLOOK FOR BELGIUM IN 1977: SECRETARIAT FEELS THAT GOB FORECAST OF 3.4 PERCENT REAL GNP GROWTH IN 1977 IS TOO HIGH AND FORECASTS RISE OF 2.75 PERCENT. SECRETARIAT SEES CONTINUED WEAKNESS IN DOMESTIC DEMAND BECAUSE (A) PRIVATE CONSUMPTION SPENDING UNLIKELY TO PROVIDE MAJOR STIMULUS TO GROWTH AND (B) RATHER DEPRESSED STATE OF BUSINESS CONFIDENCE WILL MILITATE AGAINST ACCELERATION OF PRIVATE INVESTMENT SPENDING. ACCORDING TO SECRETARIAT, PROVISIONS OF EGMONT PLAN DESIGNED TO STIMULATE INVESTMENT WILL HAVE MINIMAL EFFECT IN FACE OF GENERALLY ADVERSE BUSINESS CLIMATE. SECRETARIAT PROJECTS 8.25

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PERCENT RISE IN CONSUMER PRICES IN 1977, THUS LOWER
THAN 9.2 PERCENT INCREASE IN 1976, BUT ADDS THAT INFLA-
TION RATE IS LIKELY TO ACCELERATE DURING YEAR DUE TO
HIGHER FOOD AND ENERGY PRICES AND TO PLANNED INCREASE
IN VAT.

5. ECONOMIC PROSPECTS FOR LUXEMBOURG: SECRETARIAT
STRESSES THAT ECONOMIC DEVELOPMENTS IN LUXEMBOURG WILL
CONTINUE TO BE FUNDAMENTALLY INFLUENCED BY DEPRESSED
CONDITIONS IN STEEL MARKET AND FORECASTS ONLY 3 PERCENT
RISE IN EXPORT VOLUME AND 2 PERCENT INCREASE IN REAL
GDP.

6. BLEU CURRENT ACCOUNT: SECRETARIAT NOTES THAT BLEU
TRADE BALANCE WORSENERED CONSIDERABLY IN 1976, CONFIRMING
A TREND THAT HAD BEGUN IN 1974. IMPORT VOLUME ROSE BY
13.5 PERCENT, WHILE EXPORT VOLUME INCREASED BY 12.4 PER-
CENT (COMPARED WITH EXPORT MARKET GROWTH OF 14 PERCENT)
AND CURRENT ACCOUNT REGISTERED DEFICIT OF \$308.2 MILLION.
DESPITE SPECULATIVE RUNS ON FRANC IN 1976, EFFECTIVE
EXCHANGE RATE APPRECIATED BY 6 PERCENT BETWEEN JANUARY,
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1976 AND APRIL, 1977. FOR 1977, SECRETARIAT FORECASTS SMALL IMPROVEMENT OF BELGIAN REAL FOREIGN BALANCE (INCREASES OF 6.5 PERCENT AND 6 PERCENT, RESPECTIVELY, IN EXPORT AND IMPORT VOLUMES), BUT DETERIORATION IN TERMS OF TRADE. (HOWEVER, SECRETARIAT DOES NOT GIVE NUMERICAL CURRENT ACCOUNT FORECAST FOR 1977.)

7. BELGIAN FISCAL AND MONETARY POLICY: FISCAL POLICY IN 1976 REFLECTED RESTRICTIVE EFFECT OF "SOBRIETY PLAN" IMPLEMENTED IN MARCH, 1976. HOWEVER, DECELERATION IN GROWTH RATE AND CONSEQUENT WEAKENING OF LABOR MARKET LED GOB TO LAUNCH "EGMONT PLAN" IN EARLY 1977. OBJECTIVE OF EGMONT PLAN TO STIMULATE PUBLIC AND PRIVATE INVESTMENT, TO COMBAT UNEMPLOYMENT THROUGH DIRECT SELECTIVE MEASURES, AND PREVENT A FURTHER WIDENING OF PUBLIC SECTOR DEFICIT. MONETARY POLICY IN 1976 WAS DEVOTED TO DEFENSE OF FRANC. SECRETARIAT NOTES THAT GOB HAS NOT LAID DOWN NORMS FOR MONETARY GROWTH IN 1977.

8. LUXEMBOURG FISCAL AND MONETARY POLICY: FISCAL POLICY IN 1977 WILL FOCUS ON STIMULATION OF INDUSTRIAL ACTIVITY IN MEDIUM TERM FRAMEWORK (AID TO INVESTMENT, DIVERSIFICATION OF INDUSTRY ASSISTANCE FOR EXPORT-ORIENTED FIRMS), WHILE MONETARY POLICY LIKELY TO BE GOVERNED BY EXTERNAL CONSIDERATIONS.

9. MAIN CONCLUSIONS: BASED ON ANALYSIS REFDON, SECRETARIAT SUGGESTS THAT EDRC COME TO FOLLOWING MAIN CONCLUSIONS:

(A) GOB SHOULD INTENSIFY EFFORTS (BEGUN UNDER SOBRIETY PLAN) TO MODERATE GROWTH OF WAGES AND PRICES;

(B) NEVERTHELESS, A MAJOR GOAL OF ECONOMIC POLICY SHOULD BE TO REDUCE UNEMPLOYMENT RATE. PUBLIC INVESTMENT SHOULD BE MORE SYSTEMATICALLY CHANNELLED INTO EMPLOYMENT LIMITED OFFICIAL USE

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CREATION;

(C) OVER MEDIUM-TERM, INCREASE IN TAXES AND GREATER CONTROL OF PUBLIC EXPENDITURE WILL BE NECESSARY TO EFFECT NEEDED REDUCTION IN PUBLIC SECTOR DEFICIT;

(D) WITHIN PRUDENT LIMITS, GOB SHOULD CONSIDER SOMEWHAT MORE EXPANSIONARY DEMAND MANAGEMENT POLICY TO REDUCE UNEMPLOYMENT AND TO FACILITATE ADJUSTMENT PROCESS IN OECD AREA.

10. COMMENT: (A) IN DISCUSSION OF INVESTMENT OUTLOOK IN BELGIUM, SECRETARIAT REFERS TO WEAKNESS OF BUSINESS CONFIDENCE. SECRETARIAT ALSO NOTES THAT RESTRICTIVE SOBRIETY PLAN GAVE WAY TO EGMONT PLAN TO DEAL WITH DETERIORATING INVESTMENT AND EMPLOYMENT SITUATIONS. AT SAME TIME, MONETARY POLICY WAS ACCOMMODATED IN EARLY 1976, BUT TURNED RESTRICTIVE TO DEFEND FRANC EXCHANGE RATE. IT COULD WELL BE THAT SWING IN ECONOMY POLICY AND UNCERTAINTY OF INVESTMENT CLIMATE ARE RELATED. MISSION WOULD RAISE THIS POINT AT REVIEW; (B) SECRETARIAT COMMENTS SHIFT OF BLEU FROM "STRUCTURAL SURPLUS" INTO DEFICIT IS DESIRABLE FROM INTERNATIONAL STANDPOINT. YET, GOB MEDIUM-TERM PLAN AIMS TO SHIFT RESOURCES INTO INVESTMENT AND INTO EXPORTS AND NOTES CONSISTENCY OF THIS

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OBJECTIVE WITH OECD MEDIUM-TERM STRATEGY. SECRETARIAT AND GOB OBVIOUSLY HAVE DIFFERENT VIEWS OF WHERE BELGIUM FITS ON STRATEGY SPECTRUM OF DIFFERENTIATED POLICIES. MISSION WOULD ASK BELGIUM AND SECRETARIAT TO COMMENT ON THIS QUESTION; (C) SECRETARIAT NOTES THAT SWITCH FROM CURRENT ACCOUNT SURPLUS TO DEFICIT HAS "IMPLICATIONS FOR TREND OF ACTIVITY AND EMPLOYMENT." HOWEVER, SECRETARIAT ALSO COMMENTS THAT MAINTENANCE OF FRANC EXCHANGE RATE IN FACE OF WORSENING RELATIVE COST POSITION WAS APPROPRIATE FROM STANDPOINT OF NEED TO CONTROL INFLATION. MISSION

WOULD SOLICIT BELGIAN COMMENTS ON INFLATION/UNEMPLOYMENT
TRADEOFF IN CONTEXT OF EXCHANGE RATE POLICY; (D) ASSUM-
ING SECRETARIAT FORECASTS FOR 1977 MATERIALIZE, DEVELOP-
MENT OF SEVERAL MAJOR DEMAND COMPONENTS WILL DEVIATE
CONSIDERABLY FROM OBJECTIVES OF GOB MEDIUM-TERM PLAN
(1976-1980); PUBLIC EXPENDITURE WILL BE TOO HIGH, PRI-
VATE INVESTMENT IS TOO LOW AND PRIVATE CONSUMPTION ABOUT
"RIGHT." MOREOVER, SECRETARIAT RECOMMENDS INCREASE IN
PUBLIC INVESTMENT SPENDING OVER MEDIUM TERM. THUS, IT
IS APPARENT THAT, IN ORDER TO GET BACK ON TRACK, SUB-
STANTIAL SHIFT FROM PUBLIC CONSUMPTION TO PUBLIC AND
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PRIVATE INVESTMENT WILL BE NECESSARY. MISSION WOULD
ASK BELGIAN DEL TO COMMENT ON THIS VIEW.
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